LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS

200 W. Washington, Suite 301
Indianapolis, IN 46204
(317) 233-0696
http://www.in.gov/legislative

FISCAL IMPACT STATEMENT

LS 6717
BILL NUMBER: SB 170

NOTE PREPARED: Dec 19, 2002
BILL AMENDED:

SUBJECT: Inheritance Tax Class A Transferees.

FIRST AUTHOR: Sen. Zakas
FIRST SPONSOR:

BILL STATUS: As Introduced

FUNDS AFFECTED: X **GENERAL**
X **DEDICATED**
FEDERAL

IMPACT: State & Local

Summary of Legislation: The bill provides that a spouse, widow, or widower of a child of the transferor is a Class A transferee for purposes of the Inheritance Tax rather than a Class B transferee.

Effective Date: July 1, 2003.

Summary of Net State Impact: Under the bill, the state will experience a reduction in Inheritance Tax revenue beginning in FY 2005. Any increase in Estate Tax revenue in FY 2005 and FY 2006 due to the Inheritance Tax reduction is expected to be negligible. In addition, the bill is expected to result in a small increase in state General Fund expenditures on county Inheritance Tax replacement. The net state impact of the bill is summarized in the table below.

Fiscal Year	Inheritance Tax Revenues	Estate Tax Revenues	State Expenditures for County Replacement	Net Increase (Decrease)
2005	($1.0 M)	$50,000	($7,000 - $89,000)	($957,000 - $1.0 M)
2006	(1.0 M)	8,000	(7,000 - 89,000)	(1.0 - 1.1 M)
2007 and after	(1.0 M)	0.0	(7,000 - 89,000)	(1.0 - 1.1 M)

Explanation of State Expenditures: The bill could potentially increase expenditures from the state General Fund for county Inheritance Tax replacement by $7,000 to $89,000 annually beginning in FY 2005. Necessary replacement funding could vary within this range depending upon whether, and by how much, each county's base revenue exceeds the amount guaranteed under current statute.. (See *Explanation of Local Revenues*, below, for explanation of county revenue loss and replacement procedure.)

Explanation of State Revenues: The bill is estimated to reduce Inheritance Tax revenue by $1.0 M annually beginning in FY 2005. The reduction in Inheritance Tax liabilities is estimated to increase Indiana Estate Tax revenue by only about $50,000 in FY 2005 and $8,000 in FY 2006. Estate Tax revenue is expected to decline to zero beginning in FY 2007 due to the phaseout of the state death tax credit under the federal Estate Tax. Thus, the estimated net revenue loss is about $1.0 M annually beginning in FY 2005.

Background on Inheritance Tax: The bill would increase the Inheritance Tax exemption for transfers to a spouse, widow, or widower of a child of a transferor from $500 to $100,000. (These individuals are currently Class B transferees, entitled to a $500 exemption. The bill would change their status to Class A transferees, entitled to a $100,000 exemption.) The change would be with respect to transfers made by persons who die on or after July 1, 2003. Since the Inheritance Tax does not have to be paid until a maximum of 12 months after the decedent's death (within 9 months of the date of death to receive the 5% early payment discount), the full impact of the bill likely would not be experienced until FY 2005.The estimated impact of this change is based on the Office of Fiscal and Management Analysis (OFMA) Inheritance Tax database and the Revenue Technical Committee's FY 2005 forecast (December 18, 2002) for the Inheritance Tax totaling $120 M. The revenue forecast total is a combined amount including both Inheritance Tax and Estate Tax revenue. Approximately $118.0 M of the FY 2005 forecast amount is estimated to be attributable to the Inheritance Tax. The Inheritance Tax database is comprised of 112,951 records for transferees receiving property from a decedent who died between July 1, 1997, and June 30, 2000. Of the total tax liability for the sample, approximately 0.99% is attributable to the group identified as being a spouse, widow, or widower of a child of a transferor. This amounts to about $1.16 M based on forecasted Inheritance Tax revenue. The increase in the exemption for this sample group reduced its tax liability by about 88%. Thus, the annual reduction in revenue is estimated to total about $1.0 M assuming no change in Inheritance Tax yield through FY 2007.

Background on Estate Tax: Although the bill does not make changes to the Indiana Estate Tax, the reduction in Inheritance Tax liabilities for Class A transferees would affect Estate Tax revenues. However, this impact is expected to be negligible. Indiana Estate Tax is owed on the assets of an estate if (1) federal Estate Tax is owed on the estate and (2) the Indiana portion of the state death tax credit for federal Estate Tax purposes exceeds the total Inheritance Tax paid by transferees of the estate. Consequently, for some estates a reduction in the Inheritance Tax liability paid by transferees of the estate results in a compensating increase in the Indiana Estate Tax liability. The estimated impact of the bill on Estate Tax revenues is based on OFMA's Estate Tax database and the Revenue Technical Committee's FY 2005 forecast (December 18, 2002). We estimate that no more than $2.0 M of the FY 2005 forecast is attributable to the Estate Tax. The Estate Tax database consists of 559 estates of decedents who died between July 1, 1997, and June 30, 2000, and that paid Indiana Estate Tax. The Inheritance Tax changes provided for in the bill increased the Estate Tax liability of the sample by only 2.42% in FY 2005 and by only 1.55% in FY 2006. It is estimated that Estate Tax revenue would otherwise total about $2.0 M in FY 2005 and $530,000 in FY 2006. This accounts for the phaseout of the Estate Tax in concert with the phaseout of the state death tax credit under the federal Estate Tax. As a result, the Inheritance Tax changes are estimated to increase Estate Tax revenue by roughly $50,000 in FY 2005 and $8,000 in FY 2006.

Explanation of Local Expenditures: The bill would increase the Inheritance Tax exemption for transfers to a spouse, widow, or widower of a child from $500 to $100,000 by making these individuals Class A transferees. The revenue impact of this change coupled with county Inheritance Tax replacement could result in an annual net revenue loss to counties of as much as $82,000 beginning in FY 2005. This net impact is summarized in the table below.

	Annual Impact Beginning in FY 2005
Inheritance Tax Revenues (Local Share)	($89,000)
State Expenditures for County Replacement	7,000 - 89,000
Net Increase (Decrease)	(0.0 - 82,000)

Currently, counties retain 8% of the Inheritance Tax collected on transfers made by Indiana residents. About 99.3% of Inheritance Tax revenue is derived from the resident Inheritance Tax. Based on the FY 2005 forecast for state Inheritance Tax revenue totaling $118.0 M, annual county Inheritance Tax revenue is estimated to total about $10.2 M beginning in FY 2005. We estimate that about 0.99% of this revenue is attributable to the group identified as being a spouse, widow, or widower of a child of a transferor. This amounts to about $101,000. The increase in the exemption for this group is estimated to reduce its tax liability by about 88%. Thus, the annual reduction in revenue to counties is estimated to total about $89,000 assuming no change in Inheritance Tax yield through FY 2007. It is important to note that a reduction in the amount of Inheritance Tax retained by counties due to the bill may be reimbursed by the state under the replacement provision established by P.L. 254-1997. The replacement provision was established when the Class A exemption was increased on July 1, 1997. The replacement provision guarantees that in each fiscal year each county receives an amount under the Inheritance Tax that is equal to the five-year annual average amount of Inheritance Tax revenue retained by that county from FY 1991 to FY 1997, excluding the highest and lowest year. The maximum amount of county replacement for any year is approximately $7.5 M. Currently, most counties are retaining more revenue than is guaranteed under this replacement procedure. On average from FY 2000 to FY 2002, counties exceeded their guarantee amounts by about $3.8 M annually, with annual shortages subject to replacement totaling about $243,000. With base revenue to the counties totaling $10.4 M, the revenue loss covered by replacement funds would total about $7,000. Thus, about $82,000 in base revenue exceeding the guarantee amount would not be replaced. To the extent that base revenue is less than the estimate, replacement funding would increase and the net loss due to the bill would decline. Thus, county replacement would total $89,000 only if base revenue in each county is equal to the guarantee amount.

A copy of a spreadsheet showing the amount of Inheritance Tax replacement guaranteed to each county under P.L. 254-1997 is available from the Office of Fiscal and Management Analysis.

State Agencies Affected: Department of State Revenue.

Local Agencies Affected: Counties.

Information Sources: *State Revenue Forecast*, December 18, 2002. OFMA Inheritance Tax and Estate Tax databases.

Fiscal Analyst: Jim Landers, 317-232-9869